New Capital USD Shield Fund

Monthly Commentary | As of 31 October 2024

Executive summary

Key events in market

The Short Term US Credit bond market delivered a negative performance in October with the longest maturities the worst performer: the Fund's reference market (ICE BofA 1-3 Years US Corporate excluding 144A Index) delivered -0.44% during the month, while the 3-5y bucket -1.36% and the 10+y bucket -3.96%. The USTs yields raised in October across all the curve. The 5y yield increased by 60bps while the longest part (10y) by 50bps.

Key performance & positioning updates

At the end of October, the Fund delivered a negative absolute return of -0.58%, slightly below the reference index. The Fund ends the month with A rating, 4.99% in terms of yield, modified duration at 1.92 years (vs 1.84 years of the reference index).

House view

The MSCI world All Countries index corrected in October, registering a total return of -2.2% in the month. However, the performance since the beginning of the year remains a solid 16.4%. The performance of the MSCI ACWI was burdened by the correction in China and Asian markets as the surge seen in September was not supported by credible announcements of fiscal expansion. The month saw also increased volatility: the Vix index of implied volatility in SP500 options rose to above 22 from about 16 at the beginning of the month, levels that unsurprisingly represented a headwind to global equities.

The weakness of stock prices mirrored a sell off in fixed income markets, with the US Treasury 10-year yield adding almost 0.50% to rise to the highest since early July. Notably, the yield increase reflected a higher risk premium on top of upwardly revised expectations about future monetary policy. Furthermore, inflation expectations increased in the period, although the price of commodities, including oil, industrial metals and agricultural goods, fell. Finally, the US dollar index appreciated by more than 3%, this happened despite the price of gold of surging more than 4% for the month.

As much as these developments seem contradictory, they closely align with the increased belief amongst investors that the Republican party candidate Donald Trump has a better chance of winning the US Presidential elections than vice President Kamala Harris, the Democratic party candidate. Increased investors' focus on the US elections overshadowed the European Central Bank decision to cut rates again in October and the UK budget by the new Labour government under Keir Starmer.

Fund performance and positioning

In October the Fund delivered a return of -0.58%, slightly below the reference index. Positive relative performance can be attributed to the overweight in the very short part of the curve, that contributed around 18bps to the performance. However, the overweight in the longest maturity bonds, cost the fund around 28bps.
On duration the fund maintained a neutral stance (1.92 years vs 1.84 years of the reference market): we still hold almost 1 year underweight in the bucket 1-3y which is compensated by overweight in the 0-1y (+0.07y) and 3-5y (+0.90y). Looking at factor contribution we have 41% given by 3 years exposure, 23% from 5 years, 18% from 2 years and 11% from 1 year. 7% comes from credit spread.

From a sector point of view, the fund maintained a similar exposure than the reference market in the financial sector (55% vs 47%). What still differentiates us is the broader diversification in terms of countries and issuers given that we're underweight 19% on US names. We don't have any subordinated debt or US regional banks, and we kept 5% in very short dated USTs. They've been used for their high liquidity in case of new issues and repositioning, and also good yields provided. Market opportunity will drive us in holding USTs looking ahead.

In terms of countries, we are well diversified outside US. We are totally exposed to 12 countries belonging to the benchmark (in total 20), and other 5 which are outside the reference index and supranational (9%). Our major exposure outside US (41.7%) is in Canada (10%) and France (9.5%). Our major underweight is in US (-38%), mainly due to underweighting financials (-19%) and Industrials (-5%).

Looking at ratings, we continue to keep an overweight on the higher rating buckets AAA/AA (+16.4% vs benchmark), slightly overweight on A bucket (+0.8% which represent 44% of the portfolio) while always underweight on BBB bucket (at 19%, which is -17% vs the benchmark). We are invested in 89 positions (vs 1'544 of the reference index).

In terms of trading activities, we joined the primary market with JPM '28 and HYNMTR '27. Following some maturities, we also increased some existing positions (SOCGEN '27, LLOYDS '28, BMO '27) to increase the bucket 1-3y. It's worth noting that such decision has been taken following our investment process which implies an analysis focusing on our risk framework.

The Fund starts the new month with an A average rating (vs A- of the reference index), with a 4.99% in terms of yield and 1.92 years in terms of duration.
With the normalization of the yield curve in place, and given the multiplicative effect of the duration, our investable universe is going to be positively impacted by the slightly longer maturities. That is the reason why we have been repositioning the portfolio to some longer duration. This has temporarily increased the absolute risk which is still below the benchmark (1.60% vs 1.84%). We still think the opportunity is worth the slightly higher risk.

Given the fact we are still finding enough opportunities in the Investment Grade market, we don't need to consider HY issuers. Our defensive positioning let us not be interested in taking aggressive and volatile positioning (high yields and/or subordinated bonds). As a reference we have never been invested in Credit Suisse, China, Russia or real estate linked issuers.

The Fund has all USD denominated issuers, so no Forex exposure. In addition, we remember the Fund is an Article 8+ with 54% ESG score vs 52.5% of the reference index.

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	New Capital USD Shield Fund	ICE BofA 1-3 Year US Corporate Excluding 144a Index	Difference
1 Month	-0.58%	-0.44%	-0.14%
3 Months	+1.08%	+1.41%	-0.33%
6 Months	+3.66%	+4.02%	-0.36%
YTD	+4.11%	+4.65%	-0.54%
1 Year	+7.19%	+7.58%	-0.39%
Since Inception Annualised	+5.88%	+6.03%	-0.15%
Since Inception (13/07/2023)	+7.73%	+7.93%	-0.20%

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Outlook

The elephant in the room for November, are the US elections and the volatility linked to this. Trump's agenda of tariffs, tax cuts and immigration curbs would prove inflationary in the US, initially sending US yields higher. A Harris victory would see US yields and USD paring part of recent gains.

Fixed income markets have been sensitive to each data than signaled the likelihood of a soft landing rather than hard landing scenario. The consensus is clearly shifted towards the first camp in term of economic growth. In fact, solid US data have also boosted yields and curbed rate cut expectations.

In the last month the FED fund futures start to price a less aggressive monetary policy path for the next months. In fact, market expects a 25 bps interest rate cut for the meeting of November and an additional 80% probability of a further rate cut by year end. Markets have repriced up the path for key rates, after the solid activity data and anticipating the inflationary effect of a Trump's victory. The tone of the communication by FOMC members has not changed during the last weeks and still sticks to a positive assessment of inflation and a data driven approach. Therefore, it is likely that Chair Powell will stay data dependent over the next weeks, focusing more on labor market data, as these will probably shape the pace of future cuts.

As a final consideration, IG spreads are expected to hover around current levels in the coming months, keeping carry attractive vs Sovereign. Rating agencies have begun to adopt a cautious stance on the most cyclical European companies, either by downgrading ratings or revising outlooks downward. For this reason, selection is and will remain very important. We carefully watch ongoing automobile sector risk, where the transition to electric vehicles, intense competition from Chinese manufacturers, and sluggish demand from China are creating significant challenges. We also continue combining high quality floating rate and fixed rate securities to hedge against changes in central bank perceptions due to growth outlooks as well.

We always follow our approach that aims to maximize diversification through a strong and repeatable investment process which is focused on risk. Our proprietary risk tool is picking up a series of small idiosyncratic risks in the investment universe that we do not want to run after, while we make sure we are better diversified on the main risk factors. In fact, we continue to avoid subordinated bonds, regional banks, low liquidity issuers/bonds and countries such as China. Those elements seem to be (looking at the risk metrics) an important missing factor in our diversification but we like not to be exposed to those

factors.
Being strongly committed on delivering a cautious approach, we are fully aware we could miss some further tightening of spreads on riskier assets. We are continuously screening our universe for the positions with the highest diversification potential to find new opportunities (including new issues on the market). Quantitative and qualitative expertise are always challenging each other, to deliver the best risk adjust return for our clients.

The portfolio is well positioned to capture the upside from stabilization in either a global negative or positive scenario having a well-balanced exposure to credit, while being on a high potential position on the yield curve. We think the Fund represents a good instrument to be invested in

and this because our totally embedded risk framework process (which aims to put capital preservation on), current yields levels (not seen since 2008), and FED monetary policy ahead (tightening). Last but not least, it's worth remembering that this Fund always offers a good solution for de-risking the whole asset allocation in every portfolio providing a strong, repeatable, and effective cautious approach while investing in short term IG universe.

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agree that we may cease providing financial services to you if you are no longer a wholesale client or do not provide us with information or evidence satisfactory to us to confirm your status as a wholesale client;
and agree to notify us in writing within 5 business days if you cease to be a 'wholesale client' for the purposes of the financial services that we provide to you.

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